No. 85-43

Office-Supreme Court, U.S.
FILED
JUL 8 1985
ALEXANDER L. STEVAS,
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MICHAEL SENFT, WALTER ORCHARD,
JOSEPH ANTONUCCI and DAVID SENFT,

Petitioners,

—against—

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

BERNARD W. NUSSBAUM*
PAUL VIZCARRONDO, JR.
WACHTELL, LIPTON, ROSEN & KATZ
299 Park Avenue
New York, New York 10171
(212) 371-9200
Attorneys for Petitioner
Michael Senft

LAWRENCE S. GOLDMAN
GOLDMAN & HAFETZ
60 East 42nd Street
New York, New York 10165
(212) 682-7000
Attorneys for Petitioner
Walter Orchard

JAN LAWRENCE HANDZLIK
10960 Wilshire Boulevard
Suite 326
Los Angeles, California 90024
(213) 477-7071
Attorney for Petitioner
Joseph Antonucci

NEAL J. HURWITZ
598 Madison Avenue
New York, New York 10022
(212) 755-4300
Attorney for Petitioner
David Senft

*Counsel of Record

Questions Presented for Review

1. Did the trial court and the Court of Appeals err in allowing petitioners to be convicted of tax fraud on a theory of criminal liability that conflicts with a decision of the United States Tax Court, and were petitioners' rights to "fair warning" under the Due Process Clause of the Fifth Amendment thus violated?

2. Were petitioners' Fifth Amendment privileges against self-incrimination and Sixth Amendment right to present a defense violated by the Court of Appeals' affirmance, in conflict with a decision of the Seventh Circuit Court of Appeals, of the trial court's (a) refusal to instruct the jury on petitioners' reliance upon accountants defense, for which there was substantial support in the evidence, because petitioners did not waive their privileges and testify at trial that they relied on the accountants, and (b) refusal to allow introduction of otherwise admissible and highly probative evidence negating the key element of specific intent to violate the law, as well as negating the existence of the alleged criminal conspiracy, because petitioners offered to introduce the evidence through the testimony of a witness called by the government rather than through the testimony of one of the petitioners?

3. Were petitioners' rights under the Sixth Amendment to a unanimous verdict violated by the trial court's acceptance of verdicts that the record demonstrates the jurors did not unanimously believe to be final?

TABLE OF CONTENTS

	PAGE
Questions Presented for Review	i
Table of Authorities	v
Opinion Below	2
Jurisdiction	2
Constitutional Provisions Involved	2
Statement of the Case	3
A. The government's charges	3
B. The evidence at trial	5
C. The jury deliberations	9
D. The sentences	9
Reasons for Granting the Writ	9
1. The government's theory of criminal liability, and the trial court's jury instructions on that theory, conflict with a decision of the United States Tax Court, and thus petitioners were deprived of the "fair warning" required by the Due Process Clause of the Fifth Amendment	9
2. In denying petitioners the opportunity to present their defense and to have the jury instructed on that defense, and by punishing petitioners for refusing to testify, the decisions below were not only in direct conflict with the decision of another Court of Appeals, but also violated petitioners' rights under the Fifth and Sixth Amendments	16

PAGE

3. Petitioners' rights under the Sixth Amendment were violated by the trial court's acceptance of verdicts that the record demonstrates the jurors did not unanimously believe to be final. 24

Conclusion 26

TABLE OF AUTHORITIES

Cases:	PAGE
Andres v. *United States*, 333 U.S. 740 (1948)	25
Calder v. *Bull*, 3 Dall. 386, 1 L. Ed. 648 (1798)	14n.7
Dunn v. *United States*, 442 U.S. 100 (1979)	14
Fox v. *Commissioner*, 82 T.C. 1001 (1984)	3, 11
Frank v. *Mangum*, 237 U.S. 309 (1915)	14n.7
Gardner v. *Broderick*, 392 U.S. 273 (1968)	16
Hernandez v. *United States*, 608 F.2d 1361 (10th Cir. 1979)	23
Hoyer v. *United States*, 223 F.2d 134 (8th Cir. 1955)	23
Lefkowitz v. *Cunningham*, 431 U.S. 801 (1977)	16
Lefkowitz v. *Turley*, 414 U.S. 70 (1973)	16
Marks v. *United States*, 430 U.S. 188 (1977)	14n.7
Miller v. *Commissioner*, No. 20724-83 (T.C. May 13, 1985)	3, 12n.4
Uniformed Sanitation Men Assoc. v. *Commissioner of Sanitation*, 392 U.S. 280 (1968)	16
Smith v. *Commissioner*, 78 T.C. 350 (1982)	3, *passim*
Sincox v. *United States*, 571 F.2d 876 (5th Cir. 1978)	25
Strauss v. *United States*, 376 F.2d 416 (5th Cir. 1967)	19
Tatum v. *United States*, 190 F.2d 612 (D.C. Cir. 1951)	19, 21
United States v. *Alfonso-Perez*, 535 F.2d 1362 (2d Cir. 1976)	19
United States v. *Brown*, 411 F.2d 1134 (10th Cir. 1969)	23

PAGE

United States v. *Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), *cert. denied*, ____ U.S. ____, 104 S. Ct. 2363 (1984) 14

United States v. *DiLapi*, 651 F.2d 140 (2d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982) 25

United States v. *Dyman*, 739 F.2d 762 (2d Cir. 1984) ... 19

United States v. *Feola*, 420 U.S. 671 (1975) 22

United States v. *Garber*, 607 F.2d 92 (5th Cir. 1979) (*en banc*) 15

United States v. *Gradwell*, 243 U.S. 476 (1917) 15

United States v. *Harris*, 733 F.2d 994 (2d Cir. 1984) ...23n.11

United States v. *Harriss*, 347 U.S. 612 (1954) 14n.7

United States v. *Hicks*, 748 F.2d 854 (4th Cir. 1984).... 19

United States v. *King*, 560 F.2d 122 (2d Cir.), *cert. denied*, 434 U.S. 925 (1977) 16, 20n.9

United States v. *McLennan*, 563 F.2d 943 (9th Cir. 1977), *cert. denied*, 435 U.S. 969 (1978) 23

United States v. *Morris*, 612 F.2d 483 (10th Cir. 1979).. 25

United States v. *O'Connor*, 237 F.2d 466 (2d Cir. 1956) . 19

United States v. *Ottley*, 509 F.2d 667 (2d Cir. 1975) 23

United States v. *Platt*, 435 F.2d 789 (2d Cir. 1970) 19

United States v. *Phillips*, 217 F.2d 435 (7th Cir. 1954) 20, 21, 24

United States v. *Pomponio*, 429 U.S. 10 (1976) 22

United States v. *Reed*, 639 F.2d 896 (2d Cir. 1981) 23

United States v. *Stirling*, 571 F.2d 708 (2d Cir.), *cert. denied*, 439 U.S. 824 (1978) 18n.8

United States v. *Taylor*, 498 F.2d 390 (6th Cir. 1974) ... 25

PAGE

Washington v. *Texas*, 388 U.S. 14 (1967) 16

Williams v. *United States*, 131 F.2d 21 (D.C. Cir. 1942) . 19

Constitutional Provisions:

U.S. Const. art. I, § 9 ..... 14n.7

U.S. Const. amend. V .....2, *passim*

U.S. Const. amend. VI .....2, *passim*

Statutes and Rules:

26 U.S.C. § 165(c)(2) 11

Economic Recovery Tax Act, § 501(a), 26 U.S.C. § 1092 ..... 11n.4

Tax Reform Act of 1984, Pub. L. No. 98-369, § 108, 98 Stat. 494 (1984) 11n.4

Federal Rules of Evidence, Rule 401.....23n.11

Federal Rules of Evidence, Rule 801(c)..... 22

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. _____

MICHAEL SENFT, WALTER ORCHARD,
JOSEPH ANTONUCCI and DAVID SENFT,

Petitioners,

—against—

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE SECOND CIRCUIT

PETITON FOR A WRIT OF CERTIORARI

Petitioners Michael Senft, Walter Orchard, Joseph Antonucci and David Senft respectfully request that a writ of certiorari issue to review the order and opinion of the United States Court of Appeals for the Second Circuit, entered in this proceeding on March 29, 1985, affirming petitioners' convictions after a jury trial in the United States District Court for the Southern District of New York.

Opinion Below

The summary order and opinion of the Court of Appeals was not reported. It appears in the Appendix hereto.

Jurisdiction

The order of the Court of Appeals for the Second Circuit was filed on March 29, 1985. A timely petition for rehearing, containing a suggestion that the action be reheard *en banc*, was denied on May 10, 1985. This petition for certiorari was filed within 60 days of that date. Accordingly, this Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

Constitutional Provisions Involved

The Fifth Amendment of the United States Constitution provides:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

The Sixth Amendment of the United States Constitution provides:

> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously as-

certained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defense.

Statement of the Case

A. The government's charges

The charges in this case arise out of trading in government securities (*i.e.*, debt securities issued by the United States Treasury) conducted by Sentinel Financial Instruments ("SFI") and Sentinel Government Securities ("SGS") (collectively, "Sentinel"), two firms organized and managed by petitioner Michael Senft. This trading, known as "tax straddle" trading—in which government securities were simultaneously purchased long and sold short—was a well-known and widely used method of achieving tax losses in one year and gains in subsequent years. *See, e.g.*, *Miller* v. *Commissioner*, No. 20724-83 (T.C. May 13, 1985); *Fox* v. *Commissioner*, 82 T.C. 1001 (1984); *Smith* v. *Commissioner*, 78 T.C. 350 (1982).

The tax straddles were used to defer, from one year to the next, the payment of taxes. They were also used to reduce taxes, as the income deferred to subsequent years could often qualify for the long-term capital gains rate rather than the higher ordinary income rate. These trading and business practices, which the government claimed at trial were evidence of the alleged tax fraud, were not uncommon among, or prohibited conduct for, government securities dealers, and the government did not present evidence or contend otherwise. Many of the government's witnesses who were participants in this purported fraud scheme testified at trial that they did not believe that they had done anything unlawful. Tr. 805, 831-37, 936-37, 1202-03, 1207-11, 1245-48, 1329-31, 1340.[1]

---

1 References herein to the trial transcript are cited as "Tr."; references to government trial exhibits are cited as "GX"; references to Michael Senft trial exhibits are cited as "MS Ex."; references to Court Exhibits are cited as "Ct. Ex."; references to the Appendix hereto are cited as "App."

The government's principal contention presented to the jury below was that Sentinel's securities transactions—because they were purportedly done solely for tax avoidance purposes, with no profit motive and pre-arranged to eliminate market risk—were "bogus" and "sham" transactions without economic substance. Tr. 32-34, 47-49, 1984, 2000-02, 2021, 2323-24, 2330-34, 2339-43. Deductions taken as a result of such transactions were, according to the government, therefore false and fraudulent, and constituted criminal tax fraud. The trial judge noted that his instructions on this subject were "the heart of the case for the jury in figuring out what is going on here."[2] Tr. 1970.

The indictment below charged that petitioners were members of a conspiracy—and committed substantive offenses—that had the goal of generating "ordinary income losses and long term capital gains from bogus, pre-arranged, fictitious and manipulated trading in Treasury securities so that SFI customers and SGS partners could reduce their taxes due and owing to the Internal Revenue Service by reporting the results of the bogus trading on their federal income tax returns."[3] Indictment ¶ 13.

---

2 As will be demonstrated in Point I, *infra*, notwithstanding the government's contention and the judge's charge, the Tax Court of the United States has ruled that straddle transactions—even when done solely for tax avoidance purposes, with no profit motive and pre-arranged to eliminate market risk—are not "bogus" or "sham" transactions, provided legally binding obligations are created. *Smith* v. *Commissioner*, 78 T.C. 350, 385-94 (1982).

3 Count 1 of the indictment charged the defendants with violating 18 U.S.C. § 371 by conspiring (1) to defraud the United States and the Internal Revenue Service by impeding the IRS in the collection of income taxes and (2) to aid and assist the filing of false federal income tax returns in violation of 26 U.S.C. § 7206(2).

Most of the remaining 62 counts charged substantive violations of 26 U.S.C. § 7206(2), aiding and assisting the filing of false tax returns: counts 2 through 32, which named Michael Senft, Antonucci and David Senft, each concerned the 1979 tax return of an SFI customer; count 34, which named Michael Senft, Orchard and another defendant, concerned the 1980 SGS partnership return; count 36, which named Orchard and another defendant,

(Footnote continued on following page)

B. The evidence at trial

1. SFI

The evidence at trial showed that petitioner Michael Senft was, from approximately 1965 to 1974, a leading securities analyst on Wall Street for several prominent New York Stock Exchange firms, such as Bache & Co. In 1977, he started SFI, which bought and sold government securities for its customers. GX 110. SFI's employees included petitioner Joseph Antonucci, who had been trained as an accountant and had previously worked at Cantor Fitzgerald Securities Corp., a government securities firm, where he was controller, Tr. 299-300, 308-9, 1856; and petitioner David Senft, Michael's brother, who had no previous experience in the securities industry. Tr. 167, 334-35.

SFI sold to its customers a tax shelter program involving tax straddles in government securities. In this program, the customer would give SFI complete discretion to trade his account. Typically, SFI would put the customer into long and short positions in similar face amounts of different issues of Treasury bills. SFI, being a broker-dealer, would take the opposite side of each trade. The program was designed to realize a loss in the customer's short position that would be deductible by the customer from his ordinary income, and an approximately equal gain on the long position that would not be realized and taxable until a subsequent year.

Because it was perfectly legal to sell Treasury bills short and thereby guarantee a loss if the bills were held to maturity (since Treasury bills are sold at a discount to face value and rise in value as they approach maturity, the amount necessary later to cover a short position will always be more than one receives

---

(Footnote continued from previous page)

concerned Michael Senft's 1980 tax return; and counts 37 through 63, which named Michael Senft, Orchard and another defendant, each concerned the 1980 tax return of an SGS limited partner. Count 33 charged Michael Senft with violating 26 U.S.C. § 7206(1) by falsely subscribing to the 1980 SGS partnership return, and count 35 charged him with personal tax evasion for 1980 in violation of 26 U.S.C. § 7201.

from the short sale) and because the gains and losses on the customers' government securities positions if held to maturity could be predicted at the time the positions were entered into (the value of the security at maturity will always be its par value, or $100), it was relatively simple for SFI to plan for a customer a course of trading that would result in a realized tax loss for the current year in the amount that the customer desired and a roughly offsetting gain in the following year. Tr. 1754-57.

Virtually all trades for SFI's customers in 1979 were done by Antonucci, David Senft and another SFI employee. SFI, as a principal, was the opposite side of each of its customer's trades. SFI itself held positions with other government securities dealers that could offset or hedge SFI's customer positions. In addition, SFI paired-off internally the par values of its customers' positions to keep its own position roughly in balance. Tr. 173-76, 178-79, 317-19, 1768-69.

Through its tax straddle trading, SFI obtained tax losses for its customers in 1979 of approximately $68.7 million, and taxable gains of approximately the same amount in subsequent years. The transactions underlying the tax losses for the SFI customers cited in the indictment were done at market prices, and there was documentation to support each such transaction. Tr. 1454, 1713, 1818.

The accounting firm of Peat, Marwick, Mitchell & Co.—SFI's outside auditor—gave SFI unqualified audit opinions for its September 30, 1979 and 1980 fiscal years. It fully reviewed SFI's trading procedures—including its practice of internally pairing-off its customer positions rather than obtaining offsetting positions with other firms for all its customer positions—and found them proper and consistent with industry practice. Tr. 257-58, 654-57, 660-64, 642-43, 1661, 1670-73, 1684-88; MS Exs. 106, 701, 726.

In March 1980, Antonucci left SFI. Michael Senft had hired petitioner Walter Orchard as a trader in January 1980, and Orchard eventually took over Antonucci's trading responsibilities. Orchard was an experienced government securities trader, having previously held that position at such other Wall Street

firms as Paine Webber, Inc. and Donaldson, Lufkin & Jenrette, Inc. Tr. 195-96, 314-17, 805-06.

2. SGS

In the spring of 1980, Michael Senft decided to begin phasing out the retail customer business of SFI and to form a new limited partnership, SGS, that would be a full-range money market broker-dealer primarily trading for its own account, rather than for customers. In order to raise capital for its operations, SGS sold limited partnership units for $150,000 in cash and a promissory note obligating the limited partner to contribute an additional $450,000 if called upon to do so. As an inducement for investors to purchase limited partnership interests, SGS attempted to obtain, through tax straddle trading in government securities, 1980 tax losses of approximately four times the amount of the cash contribution of each limited partner. By the end of 1980, SGS had 88 limited partners, cash capital of approximately $14.7 million, and total capital of approximately $56.8 million. Tr. 631-32, 1387-89, 1639-40, 1646-47; GX 103; MS Ex. 704.

Michael Senft succeeded in building SGS to be a major money market dealer with substantial and profitable non-tax-oriented trading operations. In addition to government securities, it traded such money market instruments as banker's acceptances and certificates of deposit. By 1981, SGS was dealing with such leading money market trading institutions as Merrill Lynch, Pierce, Fenner & Smith; Salomon Brothers; Chase Manhattan Bank; Chemical Bank; Goldman Sachs & Co.; and A.G. Becker, Inc. Tr. 1582(47)-82(50), 1836-38.

SGS obtained a $63 million tax loss in 1980 through government securities tax straddle transactions with other firms. Tr. 1506; GX 233. The transactions underlying the tax losses for the SGS partners cited in the indictment were done at market prices, and there was documentation to support each such transaction. Tr. 1767-68, 1772-77, 1795-1804, 1818; MS Exs. 2001-26.

The government presented evidence at trial concerning SGS's 1980 tax straddle transactions with three firms, includ-

ing Lasser Marshall, Inc. The government claimed these transactions were done solely for tax avoidance purposes, with no profit motive, and were pre-arranged to eliminate market risk. Accordingly, the government contended, they were sham transactions without economic substance and illegal, and known by defendants to be so. Tr. 32-34, 47-49, 1984, 2000-02, 2021, 2323-24, 2330-34, 2339-43.

When employees of those three firms were called as witnesses by the government, however, they testified that, when they participated with SGS in the transactions at issue, they did not intend to violate the law or believe that they were doing anything unlawful. They also admitted to participating in substantially identical transactions with firms other than SGS. Tr. 805, 831-37, 936-37, 1202-03, 1207-11, 1245-48. Indeed, government witness Joseph Jay Vitrella of Lasser Marshall, Inc., was prepared to testify during cross-examination that he had told petitioner Orchard that Lasser Marshall's outside counsel—the law firm LeBoeuf, Lamb, Leiby & MacRae—had actually approved as lawful the very tax straddle trading for which petitioners were tried and convicted. Although the trial judge refused to allow the admission of this testimony, it was highly probative and critically relevant to the key defense issue—that petitioner Orchard and the other petitioners lacked specific intent to violate the law. Tr. 766-794.

SGS's outside audit firm, Peat Marwick, gave SGS a clean, unqualified audit opinion for its 1980 financial statements, as it had for the SFI 1979 and 1980 financial statements. In conducting its audits of SFI and SGS, Peat Marwick had complete and unfettered access to Sentinel and its offices. No Sentinel employee was told to hide any information or documents from Peat Marwick, and none did. Peat Marwick knew all material facts concerning the trading methods of SFI and SGS. Peat Marwick found them to be proper for a government securities dealer and consistent with industry practice. Tr. 688, 1568-71, 1640-43, 1688-93, 1703, 1713, 1719, 1743; MS Exs. 106, 701-04.

C. The jury deliberations

After more than four weeks of testimony and arguments, jury deliberations extended over seven days. The trial judge, on Friday night, June 8, 1984, took a partial guilty verdict against Michael Senft on 14 of the 62 counts in which he was named; against Orchard on 2 counts; and against Antonucci and David Senft on 13 counts each. Ct. Ex. 38.

On Monday, June 11, 1984, after the jurors delivered notes during subsequent deliberations evidencing that they had not intended that their partial verdicts be considered final, Ct. Exs. 39, 40, the District Court declared a mistrial and discharged the jury. The trial judge refused, however, to disturb the partial guilty verdicts that had been entered.

D. The sentences

Michael Senft was sentenced to four consecutive terms of imprisonment totalling 15 years, an $80,000 committed fine and the costs of prosecution. Orchard was sentenced to four years' imprisonment and a $15,000 committed fine. Antonucci was sentenced to six months' and one day imprisonment and a $10,000 committed fine. David Senft was sentenced to two years' imprisonment and a $70,000 committed fine.

Reasons for Granting the Writ

1. The government's theory of criminal liability, and the trial court's jury instructions on that theory, conflict with a decision of the United States Tax Court, and thus petitioners were deprived of the "fair warning" required by the Due Process Clause of the Fifth Amendment.

The government's indictment charged that petitioners engaged in "bogus, pre-arranged, fictitious and manipulated trading in Treasury securities" to generate "bogus and fictitious" ordinary income losses and long-term capital gains. Its theory was that Sentinel's trades were "bogus" or "sham" because—even if the trades created legally binding obligations

to deliver cash or securities—they were done solely for tax avoidance purposes, had no profit motive and were pre-arranged to eliminate market risk. Tr. 32-34, 47-49, 1984, 2000-02, 2021, 2323-24, 2330-34, 2339-43.

The prosecution repeatedly argued its theory to the jury, and the trial court, without judicial or statutory precedent, instructed the jury on this theory of criminal liability. The Second Circuit Court of Appeals, in affirming the convictions, also accepted this theory. This theory, and these rulings below, however, directly conflict with precedents of the United States Tax Court in, *e.g.*, *Smith* v. *Commissioner*, 78 T.C. 350, 385-94 (1982). Moreover, in light of the Tax Court's ruling in *Smith* that transactions of this sort are real, not shams, petitioners' convictions on this novel theory violated their right to "fair warning" under the Due Process Clause of the Fifth Amendment.

The features of Sentinel's trading attacked by the government in its "sham transaction" theory—that is, tax avoidance purpose, lack of profit motive and pre-arrangement to eliminate market risk—were common to a wide variety of tax straddle transactions that were engaged in during the time of the events at issue in this case. In 1982—after the transactions alleged in the indictment had occurred and after the government had committed itself to seeking an indictment here—the United States Tax Court squarely ruled that such transactions were not "sham," but quite "real." *Smith* v. *Commissioner*, 78 T.C. 350, 385-94 (1982).

Smith involved two tax straddle customers of Merrill Lynch, Pierce, Fenner & Smith who claimed tax losses from tax straddle transactions in silver futures contracts arranged for them on the Commodity Exchange, or Comex, in New York. The similarities between the silver trading arranged by Merrill Lynch and the trading in this case are striking. For example:

— The Merrill Lynch trades were done solely to obtain tax losses and with no purpose or hope of real economic profit. 78 T.C. at 391-92.

— The Merrill Lynch trades were "pre-arranged" in that the sequence of trades was planned and arranged in advance so that a tax loss predictable within a narrow range would be obtained in the current tax year and a corresponding gain would be obtained in the following year, with a relatively small actual trading profit or loss. (If any actual trading profit was realized, it would be smaller than the taxpayer's commission costs.) *Id.* at 390-91.

In *Smith*, the government attacked the deductibility of these losses on several grounds: (1) there were no genuine losses realized—the losses were all shams; (2) the losses were but one step in a series of transactions that had to be integrated and recognized only upon conclusion of the scheme; (3) the transactions lacked "economic substance;" and (4) the losses, if real, were not deductible under Section 165(c)(2) of the Internal Revenue Code, because they were not incurred in a transaction entered into for profit. 78 T.C. at 370.

The Tax Court agreed with the government that the taxpayers had invested in commodity tax straddles—*i.e.*, a pre-arranged, planned sequence of trading—solely for tax avoidance purposes, 78 T.C. at 390-91, but rejected all but the last of the government's arguments as to why the losses should be disallowed—*including the arguments that the losses were shams and that the transactions lacked economic substance.* It ruled that the losses should be disallowed as deductions *only because* Merrill Lynch's customers had not entered into the straddle transactions for profit within the meaning of Section 165(c)(2) of the Internal Revenue Code, 26 U.S.C. § 165(c)(2). 78 T.C. at 394. *See also Fox* v. *Commissioner*, 82 T.C. 1001 (1984).[4]

---

4 In 1981, Congress enacted a statute that had the purpose and effect of preventing recognition of tax straddle losses for years *after 1981* (the tax losses at issue in *Smith* and in the case at bar were for years prior to 1981). Economic Recovery Tax Act, § 501(a), 26 U.S.C. § 1092. In 1984, Congress enacted Section 108 of the Tax Reform Act of 1984, Pub. L. No. 98-369, § 108, 98 Stat. 494 (1984), which the Tax Court has recently held was

(Footnote continued on following page)

Of particular significance here is the Tax Court's rejection of the government's argument in *Smith*—which is essential to its theory of prosecution in the instant case—that the losses were entirely sham. The Tax Court first ruled that the prices that Merrill Lynch had ascribed to each leg of the tax straddle were artificial and should be replaced by real market prices. 78 T.C. at 378, 381-82. Using these real market prices, the Tax Court calculated that losses from these trades for each Merrill Lynch customer in the case were actually $5,754, rather than the $95,424 claimed by each on his tax return. 78 T.C. at 383-84.

Once real market prices had been assigned to the trades (*in the case at bar, Sentinel's trades were always done at market prices*), the Tax Court rejected the argument that the resulting losses were "sham" and not "real":

> *These $5,754 losses were real, not shams.* They were the product of commodity trading actually engaged in pursuant to COMEX rules during the straddle trading sessions on August 7 and 9.
>
> *The contracts traded were legally binding on the parties* under the rules of the COMEX; if [the taxpayers] had not, through later independent trades, closed out their August 7 positions, delivery rights and obligations respecting the underlying commodity, silver, would have ensued. *Such losses may not be disallowed on the grounds of sham.*
>
> — 78 T.C. at 385 (emphasis added; footnote omitted).

(Footnote continued from previous page)

intended to, and did, overrule the holding in *Smith* that pre-1981 tax straddle losses should be disallowed where the taxpayer's subjective primary purpose in entering into the transaction was not profit but, rather, tax avoidance. *Miller* v. *Commissioner*, No. 20724-83 (T.C. May 13, 1985). Several of the Tax Court judges in *Miller* noted that the result of Congress' 1984 action, and the majority opinion in *Miller*, is in effect to grant amnesty from *civil* disallowance and penalties for tax straddle losses prior to 1981—a grim irony for the petitioners here, who are now serving *criminal* tax fraud jail sentences, as long as 15 years, for arranging such losses.

Smith thus holds that trades creating "rights and obligations" that are "legally binding on the parties" are not sham transactions, notwithstanding that the taxpayers had no profit motive and entered into the transactions only for tax purposes.

In the case at bar, the government urged the trial court to disregard the Tax Court's decision in *Smith*. The trial court did so in instructing the jury on the government's theory that Sentinel had created fraudulent tax losses through "sham transactions" without economic substance—instructions that, the trial court noted, were "the heart of the case for the jury figuring out what's going on here." Tr. 1970. Those instructions were twice repeated during the jury's deliberations in response to two jury notes requesting clarification of the legal standards governing tax-oriented trading.[5]

The trial court's charge, upheld by the Second Circuit, thus squarely conflicts with the Tax Court's decision in *Smith*.[6] It

---

5 The court instructed the jury as follows:

> I instruct you that a transaction without economic substance which is entered into solely for the purpose of tax avoidance cannot properly be used to compute taxes. The government contends that the losses reported on the various returns referred to in the indictment were false and fraudulent in that they were based on sham transactions without economic substance either individually or in their totality.
>
> A taxpayer may, of course, try to pay as little tax as possible as long as he uses legal means. Transactions may be arranged in an attempt to minimize taxes if the transactions have economic substance.
>
> The defendants contend that the transactions were real, creating binding obligations with economic substance and therefore the said losses were not false and fraudulent.
>
> Therefore, *on this element, the falsity of a material matter,* you must find beyond a reasonable doubt either that the transactions themselves were not intended to and did not create binding obligations and were structured solely for the purpose of tax avoidance or *even if you find that each separate transaction did create a binding obligation, but you also find that in their totality they were not intended to have and in fact had no economic substance or significance and were entered into solely for the purpose of tax avoidance, then in either case I charge you that any losses based on these transactions thereafter reported on any return were false and fraudulent.*
>
> — Tr. 2459-60
> (emphasis added).

6 In upholding the District Court's instructions, the Court of Appeals incorrectly stated that petitioners contended on appeal that "because a few trades actually were conducted, the jury was precluded from finding a lack of

(Footnote continued on following page)

permitted the jury to find that the tax straddle transactions in question here were false and fraudulent, and to convict the defendants, *even if it found that the transactions created legally valid and binding obligations.*

In addition to conflicting with the Tax Court's decision in *Smith*, the convictions in the case at bar violated petitioners' right to "fair warning" under the Due Process Clause of the Fifth Amendment. *See, e.g., Dunn* v. *United States*, 442 U.S. 100, 112-13 (1979). For even if this Court were ultimately to conclude that the Tax Court's interpretation of the tax laws was incorrect, it is surely a violation of fundamental fairness for the government to imprison the petitioners on a theory the Tax Court of the United States has held to date is not even sufficient to state a violation of the *civil laws*.[7]

In *United States* v. *Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), *cert. denied*, ____ U.S. ____, 104 S. Ct. 2363 (1984), a case analogous to the instant one, the defendants were convicted of conspiracy to defraud the United States and of wilfully aiding and assisting the preparation of fraudulent and false tax returns on the basis of their promoting and selling of tax shelter programs using foreign trusts. In reversing the convictions on due process grounds, the Ninth Circuit stated:

(Footnote continued from previous page)
beneficial interest." App. 3a. Petitioners made no such contention at trial or on appeal. Rather, petitioners argued that, in accordance with *Smith*, the existence of binding obligations precluded a finding that the transactions were shams without economic substance, whereas the District Court's charge permitted the jury to make such a finding even if it found "that each separate transaction did create a binding obligation."

7 While the *Ex Post Facto* Clause of Article I, Section 9 of the Constitution is a limitation upon the powers of the legislature, *see Calder* v. *Bull*, 3 Dall. 386, 1 L. Ed. 648 (1798), and does not of its own force apply to the judicial branch of government, *Frank* v. *Mangum*, 237 U.S. 309, 344 (1915), the principle on which the Clause is based—the notion that persons have a right to fair warning of that conduct that will give rise to criminal penalties—is fundamental to our concept of constitutional liberty. *See Marks* v. *United States*, 430 U.S. 188, 191-192 (1977); *United States* v. *Harriss*, 347 U.S. 612, 617 (1954). As such, that right to fair warning is protected by the Due Process Clause of the Fifth Amendment. *Marks*, *supra*, at 192. As the Court has noted, "[t]he underlying principle is that no man shall be held criminally responsible for conduct which he could not reasonably understand to be proscribed." *Harriss*, *supra*, at 617.

> We are convinced that the legality of the tax shelter program advocated by the appellants in this case was completely unsettled by any clearly relevant precedent on the dates alleged in the indictment. "It is settled that when the law . . . is highly debatable, a defendant—actually or imputedly—lacks the requisite intent to violate it." United States v. Critzer, 498 F.2d 1160, 1162 (4th Cir. 1974). . . .
>
> . . . .
>
> These appellants were prosecuted in spite of the fact that no statute, regulation or court decision gave fair warning that advocacy of the creation of lawful foreign trust corporations as a tax shelter would result in a criminal prosecution if the challenged transaction might later be held to lack economic substance for purposes of a civil tax proceeding.
>
> — 713 F.2d at 1428, 1429.

When the propriety under standards of *civil* tax liability of the conduct at issue here and in *Smith* was hotly debated during the period relevant to this indictment, the courts' below disregard of *Smith* and upholding of the legal sufficiency of the government's "sham transaction" theory violated due process. "[A] criminal proceeding . . . is an inappropriate vehicle for pioneering interpretations of tax law," *United States* v. *Garber*, 607 F.2d 92, 100 (5th Cir. 1979) (*en banc*), and courts must decline to impose punishment for actions that are not "plainly and unmistakably proscribed." *United States* v. *Gradwell*, 243 U.S. 476, 485 (1917).

The conflict between this case and the Tax Court's decision in *Smith*, and the violation of petitioners' rights to "fair warning" under the Due Process Clause of the Fifth Amendment, warrant the granting of certiorari to review the order below.

2. In denying petitioners the opportunity to present their defense and to have the jury instructed on that defense, and by punishing petitioners for refusing to testify, the decisions below were not only in direct conflict with the decision of another Court of Appeals, but also violated petitioners' rights under the Fifth and Sixth Amendments.

This Court's cases establish that "a State may not impose substantial penalties because a witness elects to exercise his Fifth Amendment right not to give incriminating testimony against himself." *Lefkowitz* v. *Cunningham*, 431 U.S. 801, 805 (1977); *see also Lefkowitz* v. *Turley*, 414 U.S. 70, 83-84 (1973); *Uniformed Sanitation Men Assoc.* v. *Commissioner of Sanitation*, 392 U.S. 280, 283-84 (1968); *Gardner* v. *Broderick*, 392 U.S. 273, 278-79 (1968). In the instant case, petitioners suffered the substantial penalty of violation of their "right to present a defense," *Washington* v. *Texas*, 388 U.S. 14, 19 (1967)—a right that this Court has recognized is an essential ingredient of the Sixth Amendment, *id.*—because they declined to testify at trial and surrender their Fifth Amendment privileges.

Petitioners' right to present their defense was penalized in two respects. *First*, the trial court denied petitioners' request for a jury instruction on a theory of their defense—reliance upon accountants—for which there was already substantial evidence, because petitioners did not take the stand and testify that they relied on the accountants. *Second*, the trial court excluded highly probative evidence negating the key element of specific intent to violate the law, as well as negating the existence of the alleged criminal conspiracy, because petitioners declined to waive their Fifth Amendment privileges and testify about the matter themselves.

The Second Circuit upheld the trial court's rulings, stating as follows:

> There is no proof that appellants relied upon the auditors' beliefs and, in the face of the overwhelming proof of knowing and intentional fraud, such reliance could not be inferred. *See United States* v. *King*, 560 F.2d 122, 132 (2d

> Cir. 1977), *cert. denied*, 434 U.S. 925 (1977). This fact was correctly recognized by the district court when it refused to charge the jury on the issue of good faith reliance. *Id.* Conversations between an outside firm and its attorneys concerning the transaction of business with SGS was also properly excluded for similar reasons.
>
> — App. 3a-4a.

There was in fact ample proof at trial of petitioners' reliance on the auditors and on the conversation referred to in the above-quoted passage. What there was not—because petitioners did not testify at trial—was direct evidence in the form of petitioners' testimony that they relied. It was because of this absence of petitioners' testimony that the trial court refused to give petitioners' requested reliance on accountants jury instruction and excluded the proffered testimony. That is what the Second Circuit meant when it stated there was "no proof" and upheld the trial court.

As will be demonstrated below, there was ample basis, apart from petitioners' testimony, for giving the requested jury instruction and admitting the excluded testimony. As will be further demonstrated, the Second Circuit's decision requiring testimony by petitioners of reliance directly conflicts with a decision of the Seventh Circuit Court of Appeals. And furthermore, by approving the trial court's interference with petitioners' fundamental right to present a defense because of their refusal to testify, the Court of Appeals violated petitioners' Fifth and Sixth Amendment rights.

a. *The refusal to instruct the jury on a theory of the defense for which there was substantial evidence.* The instructions requested by petitioners on their defense of reliance on accountants, which the trial court refused to give, was an accurate statement of law, and the trial court did not find to the contrary in rejecting it.[8] Tr. 1951-57. Rather, the trial court

8 The charge that petitioners requested, and that the trial court refused, was as follows:

> In determining whether a defendant acted wilfully and with the intent required on each count of the indictment that you are consider-

(Footnote continued on following page)

denied petitioners' request because petitioners refused to waive their Fifth Amendment privileges not to testify. Tr. 1952.

There was extensive testimony and documentary evidence from Peat Marwick—SFI's and SGS's outside accountants —and others that Peat Marwick was fully aware of the salient features of Sentinel's business practices. For example, a Peat Marwick audit partner testified that Peat Marwick had given SFI and SGS "clean" or "unqualified" opinions on their financial statements, Tr. 1640-43; a former Sentinel employee, called as a witness by the government, testified that Michael Senft referred him to Peat Marwick when the employee expressed doubts as to the propriety of SFI's trading practices, Tr. 660-63; the same former employee further testified that no one ever told him, when he was Sentinel's chief financial officer, to withhold any information from Peat Marwick or to lie to Peat Marwick, Tr. 663, which testimony was supported by the testimony of Sentinel's internal supervisor of accounting and operations, also called as a witness by the government, Tr. 1569; and Peat Marwick's workpapers showed that Peat Marwick was fully aware of the essential aspects of Sentinel's business. MS Exs. 721, 723, 727, 727A, 728-29.

Together this evidence comprised a more than adequate showing from which a reasonable jury might have concluded that petitioners had in good faith relied on Peat Marwick and did not have the requisite specific criminal intent. Yet the trial court refused to instruct the jury on petitioners' reliance on accountants defense because none of the petitioners took the stand and expressly testified that he so relied. Tr. 1952-54.

(Footnote continued from previous page)

> ing, if you find that the defendant relied in good faith upon the advice of accountants and that such accountants were fully informed as to the trading activities of SFI and SGS, then you may find that such reliance upon the advice of accountants shows that the defendant or defendants did not act wilfully and with the necessary intent to violate the law and, therefore, should be acquitted on the count of the indictment that you are considering.

This requested instruction correctly stated the law. *See United States* v. *Stirling*, 571 F.2d 708, 735 (2d Cir.), *cert. denied*, 439 U.S. 824 (1978).

This refusal to give a reliance on accountants instruction was all the more remarkable because the Second Circuit's own precedents recognize that a trial court cannot refuse a requested jury instruction on a theory of defense on the ground that a defendant had not introduced enough evidence to prove the defense: "A defendant 'is entitled to have instructions presented relating to any theory of defense for which there is any foundation in the evidence, . . .' " *United States* v. *Dyman*, 739 F.2d 762, 772 (2d Cir. 1984) (*quoting United States* v. *Platt*, 435 F.2d 789, 792 (2d Cir. 1970)). *Accord United States* v. *Alfonso-Perez*, 535 F.2d 1362, 1365 (2d Cir. 1976); *United States* v. *O'Connor*, 237 F.2d 466, 474 n.8 (2d Cir. 1956).[9]

This right to have the jury instructed on a theory of defense for which there is *any* evidentiary support is of constitutional dimension. The Sixth Amendment right to trial by an impartial jury entitles a defendant "to have presented instructions relating to a theory of defense for which there is any foundation in the evidence, even though the evidence may be weak, insufficient, inconsistent, or of doubtful credibility." *Tatum* v. *United States*, 190 F.2d 612, 617 (D.C. Cir. 1951). *See also United States* v. *Hicks*, 748 F.2d 854, 857-58 (4th Cir. 1984) ("If the trial judge evaluates or screens the evidence supporting a proposed defense, and upon such evaluation declines to charge on that defense, he dilutes the defendant's jury trial by removing the issue from the jury's consideration. In effect, the trial judge directs a verdict on that issue against the defendant. This is impermissible."); *Strauss* v. *United States*, 376 F.2d 416, 419 (5th Cir. 1967); *Williams* v. *United States*, 131 F.2d 21, 23 (D.C. Cir. 1942) (while "trial by a jury of peers is supposed to safeguard our institution of fair trial by insuring impartiality[,] . . . of what value is an open mind if it does not know, with

---

9 In *United States* v. *King*, 560 F.2d 122, 132 (2d Cir.), *cert. denied*, 434 U.S. 925 (1977)—the sole authority cited by the Court of Appeals in upholding the trial court—the defendant who sought the reliance instruction had "specifically testified on cross-examination that he did not recall relying on counsel before signing the representation letters" at issue. 560 F.2d at 132. There was no such concession here.

clear delineation, the issues upon which it is to pass judgment?").

The Second Circuit's affirmance of the trial court's ruling that a defendant must first testify as to reliance before being entitled to a jury instruction on the defense not only conflicts with petitioners' rights under the Fifth and Sixth Amendments, but also directly conflicts with a decision of the Seventh Circuit. In *United States* v. *Phillips*, 217 F.2d 435 (7th Cir. 1954), the Seventh Circuit reversed a conviction because of the trial court's refusal to give the defendant's requested reliance on counsel charge. In so doing, the Seventh Circuit made a full refutation of the Second Circuit's reasons for upholding the trial court's refusal to give a reliance on accountants instruction here:

> The sole reason given by the court for its refusal was, "I will refuse No. 13, and my reason for doing it is in the court's opinion there is nothing in the record to support the instruction. If the defendant wanted to avail himself of that defense, he should have called Mr. Porikos and had him testify to that effect, as his own witness." Thus it is inherent in this statement, given as the reason for denying the instruction, that the defendant was not entitled to an instruction based upon favorable testimony given by government's witnesses, but that as a prerequisite to his right to such an instruction, there must be testimony coming from his side of the case. We think this was clearly an erroneous idea, the effect of which was to shift the burden of proof.
>
> . . . .
>
> *We can think of no more important circumstances as bearing upon the crucial issue in a criminal prosecution for tax evasion than that the defendant acted in good faith upon the advice of an attorney. And where there is proof that he did so, irrespective of whether it comes from the witnesses of the government or those of the defendant, he is entitled to have the issue of his asserted good faith reliance submitted to the jury,* under instruc-

tion, to be considered with all the other circumstances in proof in arriving at a decision as to whether the defendant "did wilfully and knowingly attempt to defeat and evade" taxes. It is not the province of this court, and neither was it that of the trial court, to appraise the reasonableness or unreasonableness of the evidence relative to the advice of counsel theory. As was stated in *Tatum* v. *United States*, 88 U.S. App. D.C. 386, 190 F.2d 612, 617:

> "That is unnecessary, for 'in criminal cases the defendant is entitled to have presented instructions relating to a theory of defense for which there is any foundation in the evidence, even though the evidence may be weak, insufficient, inconsistent, or of doubtful credibility.' "
>
> — 217 F.2d at 440, 442-43 (emphasis added).

In sum, the Second Circuit's decision in this case conflicts with that of the Seventh Circuit in *Phillips*, and upholds the trial court's imposition of a penalty on petitioners that violated petitioners' constitutional rights—their Sixth Amendment right to present their defense and to have the jury instructed on a theory of their defense—because of petitioners' exercise of another constitutional right, their Fifth Amendment privileges. These multiple violations of petitioners' constitutional rights and the conflict with the Seventh Circuit's decision warrant a grant of certiorari to review the order below.

b. *The exclusion of testimony negating the requisite specific intent and the existence of the conspiracy alleged.* At trial, on cross-examination of a witness called by the government, Joseph Jay Vitrella (a securities trader employed by Lasser Marshall, Inc., a securities brokerage firm), petitioners proffered that Vitrella would testify that Lasser Marshall's outside attorneys (LeBoeuf, Lamb, Leiby & MacRae) had been asked by Lasser Marshall to review the propriety of proposed trading between Sentinel and Lasser Marshall. This trading (which

eventually occurred) was directly responsible for a substantial amount of the losses the indictment charged were fraudulent, and was identical to the trading responsible for all the "fraudulent" losses attributable to SGS. Vitrella would have testified that LeBoeuf, Lamb concluded that Sentinel's trading was proper, and further that he, Vitrella, reported this conclusion to defendant Walter Orchard. Tr. 766-794.

The defense proffered this testimony (as non-hearsay under Fed. R. Evid. 801(c)) in order to show that defendant Orchard and the entities named as co-conspirators did not possess the requisite specific intent to violate the law, *see United States* v. *Pomponio*, 429 U.S. 10, 12 (1976); *United States* v. *Feola*, 420 U.S. 671, 686-88 (1975), and that therefore the conspiracy alleged by the government did not exist. Vitrella's testimony would at the very least have served as important indirect evidence of the states of mind of Orchard and the other alleged co-conspirators.

The trial court excluded Vitrella's testimony, however, on the ground that because petitioner Orchard did not take the stand, there was no evidence that Orchard relied on what Vitrella told him, and that therefore the testimony was not relevant or probative concerning Orchard's state of mind. Tr. 766-99. The Second Circuit affirmed this ruling.[10]

Prior to the rulings in this case, it was well established that state of mind, like any ultimate fact to be proved, could be shown through direct or indirect evidence. *See, e.g., United*

---

10 The Court of Appeals' discussion of this ruling is contained in a single sentence: "Conversations between an outside firm and its attorneys concerning the transaction of business with SGS was also properly excluded for similar reasons." App. 4a. The "similar reasons" referred to are those relied upon by the Second Circuit in upholding the trial court's refusal to give the requested reliance upon accountants charge—*i.e.*, lack of evidence of reliance by petitioners upon their accountants—because no petitioner took the stand and so testified. Moreover, the Court of Appeals' decision incorrectly described the excluded testimony. It was not, as the court wrote, "[c]onversations between an outside firm and its attorneys," but the *report* of these conversations *to a defendant*.

States v. *Brown*, 411 F.2d 1134, 1137 (10th Cir. 1969) ("[T]he accused as part of his defense is entitled to wide latitude in the introduction of evidence which tends to show lack of specific intent."); *Hoyer* v. *United States*, 223 F.2d 134, 139 (8th Cir. 1955) ("evidence on the question of intent, where that is material, may take a wider range than is allowed in support of other issues, otherwise there would often be no means to disclose the purpose of the act charged in which the very gist of the offense may consist").[11]

There can be no doubt that testimony that one of the petitioners was told that a law firm retained by a third party had examined Sentinel's trading methods and found them proper is "relevant"—and powerfully so—where, as here, the defendant is being tried for a specific intent crime. Indeed, there are numerous cases upholding the admission of analogous testimony offered by the *government* to prove a defendant's criminal state of mind. *See, e.g.*, *United States* v. *Reed*, 639 F.2d 896, 908 (2d Cir. 1981); *Hernandez* v. *United States*, 608 F.2d 1361, 1364 (10th Cir. 1979); *United States* v. *McLennan*, 563 F.2d 943, 946-47 (9th Cir. 1977), *cert. denied*, 435 U.S. 969 (1978). If there was to be an issue of fact as to actual reliance by Orchard upon his conversation with Vitrella, then that should have concerned the weight to be accorded the evidence, rather than its admissibility. *See United States* v. *Ottley*, 509 F.2d 667, 673-74 (2d Cir. 1975).[12]

---

11 *See also United States* v. *Harris*, 733 F.2d 994, 1004 (2d Cir. 1984) (reversible error to exclude defense based on witness' testimony as to out-of-court statements by defendant offered "as circumstantial evidence of the defendant's state of mind"); Fed. R. Evid. 401 (evidence is relevant if it has "*any* tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence" (emphasis added)).

12 Most tellingly, the District Court Judge was willing to allow Sentinel's *attorneys* to offer the same type of evidence that petitioners sought to introduce through Vitrella's testimony. The District Judge explained:

> [I]t seems to me appropriate that Messrs. Cadwalader or Wickersham or Taft [Sentinel's attorneys] or any representative could get on the witness stand and say "yes, this is the opinion we gave."

(Footnote continued on following page)

The Second Circuit decision again conflicts with *United States* v. *Phillips*, 217 F.2d 435 (7th Cir. 1954), discussed above, where the Seventh Circuit held—correctly, as the authorities cited above demonstrate—that testimony by a government witness alone, without any testimony being offered by the defendant, can support a defense of reliance upon the advice of an attorney.

In sum, exclusion of testimony highly relevant to petitioners' defense amounted to the imposition of an unconstitutional penalty in response to petitioners' exercise of their Fifth Amendment rights. In effect, petitioners were unreasonably forced to forego their Sixth Amendment right to present their defense in order to assert their Fifth Amendment privileges. The Second Circuit's decision also conflicts with the Seventh Circuit's decision in *Phillips*. For this reason, alone or in conjunction with the Second Circuit's approval of the violations of petitioners' constitutional rights in refusing to give the requested reliance on accountants instruction, a grant of certiorari to review the order of the Second Circuit is warranted.

3. Petitioners' rights under the Sixth Amendment were violated by the trial court's acceptance of verdicts that the record demonstrates the jurors did not unanimously believe to be final.

After six days of deliberation, the jury in this case reported, first, that it was deadlocked, Ct. Ex. 34, and, subsequently, that it had reached a decision on certain counts as to certain defendants. Ct. Ex. 38. The trial court then took a partial verdict without informing the jury that it had the option of not delivering a partial verdict and that such a verdict would be

---

(Footnote continued from previous page)

> Obviously, were that to be the fact, such witness could be cross-examined on "what input did you have," "what input did you not have," and that would be entirely appropriate and I'd be perfectly prepared to receive it and it would be appropriate for the jury to consider.
>
> — Tr. 794.

Given that Vitrella could have been subject to virtually the same type of cross-examination, it was utterly arbitrary to have excluded his testimony.

final and not subject to later revision. On the next day of the jury deliberations, the jury sent out a note clearly indicating that it had not in fact understood that, by reporting its partial verdicts, it was reporting *final* verdicts.[13] Ct. Ex. 40.

The partial verdicts rendered under these circumstances violated petitioners' Sixth Amendment rights to have any verdict in a federal criminal trial, partial or not, be a decision that the jury unanimously believed to be final. *Andres* v. *United States*, 333 U.S. 740, 748 (1948); *United States* v. *Morris*, 612 F.2d 483, 488-89 (10th Cir. 1979); *Sincox* v. *United States*, 571 F.2d 876, 878 (5th Cir. 1978); *United States* v. *Taylor*, 498 F.2d 390, 391-92 (6th Cir. 1974).

The Court of Appeals' ruling that "[n]othing in the instant case indicates that the jury's partial verdict was intended to be anything but final," App. 6a, is not only belied by the record, but is contrary to the Second Circuit's own previous opinion in *United States* v. *DiLapi*, 651 F.2d 140 (2d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982). In *DiLapi*, the Second Circuit held that before a trial court takes a partial verdict, it should instruct the jury that it has the option of returning a partial verdict or of deferring reporting any verdict until the conclusion of its deliberations, and that, if it chose to return a partial verdict, it would be final. There was no such instruction here. Yet the Court of Appeals' opinion in this case did not even cite *DiLapi* or deal with the trial court's failure to adhere to the Second Circuit's procedure for protecting a criminal defen-

---

13 The note read:

> Should each count from 2 to 27 be judged collectively or individually? — Ct. Ex. 40.

Since verdicts had already been reported on some (but not all) of Counts 2 through 27, this question only made sense if the jury believed its partial verdicts could be reconsidered.

This view that the jury had not understood itself to be rendering final verdicts was also supported by an earlier note evincing one juror's feeling that she had been coerced into returning a partial verdict. The note read:

> To whom it may concern, a juror feels that she was pressured into changing her convictions simply because she was outnumbered. — Ct. Ex. 39.

dant's constitutional right to a decision that the jury unanimously believes to be final.

The Court of Appeals' affirmance of verdicts that the jury indicated it did not understand to be final, in violation of petitioners' Sixth Amendment right to a unanimous verdict, justifies a grant of certiorari.

Conclusion

For these reasons, it is respectfully submitted that a writ of certiorari should issue to review the order and opinion of the Second Circuit.

Dated: July 8, 1985

Respectfully submitted,

BERNARD W. NUSSBAUM
(Counsel of Record)
PAUL VIZCARRONDO, JR.
WACHTELL, LIPTON, ROSEN & KATZ
299 Park Avenue
New York, New York 10171
(212) 371-9200

Attorneys for Petitioner
Michael Senft

LAWRENCE S. GOLDMAN
GOLDMAN & HAFETZ
60 East 42nd Street
New York, New York 10165
(212) 682-7000

Attorneys for Petitioner
Walter Orchard

JAN LAWRENCE HANDZLIK
10960 Wilshire Boulevard
Suite 326
Los Angeles, California 90024
(213) 477-7071

Attorney for Petitioner
Joseph Antonucci

NEAL J. HURWITZ
598 Madison Avenue
New York, New York 10022
(212) 755-4300

Attorney for Petitioner
David Senft

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 29th day of March, One Thousand Nine Hundred and Eighty-five.

PRESENT:

HON. WILLIAM H. TIMBERS,
HON. ELLSWORTH A. VAN GRAAFEILAND,
HON. LAWRENCE W. PIERCE,
Circuit Judges.

84-1254, 84-1264, 84-1281, 84-1286

UNITED STATES OF AMERICA,
Appellee,

v.

MICHAEL SENFT, WALTER ORCHARD,
JOSEPH ANTONUCCI, and DAVID SENFT,
Defendants-Appellants.

ORDER

Michael Senft, Walter Orchard, Joseph Antonucci and David Senft appeal from judgments of conviction which followed a jury trial in the United States District Court for the Southern District of New York before Judge Owen. All four appellants were found guilty of conspiracy to defraud the United States through fraudulent tax shelter schemes and of aiding and assisting the filing of false tax returns. Additionally, Michael Senft was convicted of personal income tax evasion.

The fraudulent schemes involved phantom trading in government securities, rigged so as to give investors apparent tax

losses, together with the phony documentation and misleading representations that were an essential part of the fraudulent transactions. The trading purportedly was done by two limited partnerships, Sentinel Financial Instruments (SFI) and Sentinel Government Securities (SGS). The aiding and assisting counts resulted from the filing of false returns by investors and by Michael Senft himself.

The Government's proof, which we need not recount, convincingly established appellants' guilt on all the counts on which they were convicted. There is no merit in appellants' contention that the conduct which furnished the basis for the conspiracy conviction was not criminal in nature. The sham transactions, which had no economic effect and whose only purpose was tax avoidance, were legally insufficient to justify the tax benefits that were promised and claimed. *See Knetsch v. United States*, 364 U.S. 361 (1960); *United States v. Ingredient Technology*, 698 F.2d 88, 93-97 (2d Cir.), *cert. denied*, 103 S. Ct. 3011 (1983); *Lynch v. C.I.R.*, 273 F.2d 867, 871-72 (2d Cir. 1959); *United States v. Winograd*, 656 F.2d 279, 283 (7th Cir. 1981), *cert. denied*, 455 U.S. 989 (1982); *United States* v. *Clardy*, 612 F.2d 1139, 1151-53 (9th Cir. 1980).

Appellants' numerous claims of procedural error are equally without merit. The district court did not err in permitting the Government to introduce evidence derived from the police search of the SFI and SGS office. Assuming for the sake of argument that at least one of the appellants had a sufficient privacy interest in the premises to be able to challenge the search, the challenge must fail. A magistrate's finding of probable cause is entitled to substantial deference. *United States v. Travisano*, 724 F.2d 341, 345 (2d Cir. 1983). Based on the affidavit of an I.R.S. agent, which set forth detailed information secured from a former executive of both SFI and SGS concerning the method of operation of the two firms, the magistrate properly could find that fraud so permeated the operations as to justify the search and seizure of the business records described. *See National City Trading Corp. v. United States*, 635 F.2d 1020, 1026 (2d Cir. 1980). Having failed to make a substantial showing that statements necessary to the

finding of probable cause were recklessly or intentionally false, appellants were not entitled to a *Franks* hearing. *See Franks v. Delaware*, 438 U.S. 154, 155-56 (1978). The warrants themselves did not lack sufficient particularity. *United States v. Mankani*, 738 F.2d 538, 546 (2d Cir. 1984); *National City Trading Corp. v. United States*, *supra*, 635 F.2d at 1026.

The district court correctly instructed the jury that the losses claimed would be fraudulent if the jury found that the challenged transactions "in their totality . . . were not intended to have and in fact had no economic substance and were entered into solely for the purpose of tax avoidance." *See United States v. Ingredient Technology*, *supra*, 698 F.2d at 93-97 & n.9. Appellants contend that, because a few trades actually were conducted, the jury was precluded from finding a lack of beneficial interest. However, "it is well settled that acts which are in themselves legal lose that character when they become constituent elements of an unlawful scheme." *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 707 (1962).

A detailed discussion of the challenged evidentiary rulings of the district court is unnecessary because of the lack of substance in appellants' numerous claims of error. "Absent abuse of discretion, evidentiary rulings will rarely be disturbed on appeal." *United States v. Asbury*, 586 F.2d 973, 978 (2d Cir. 1978). We see no abuse of discretion or prejudicial error in any of the rulings complained of. The district court properly admitted the letters and lists of SFI and SGS salesmen as sufficiently authenticated agents' admissions, Fed. R. Evid. § 901(a), and other challenged documents as records kept in the ordinary course of business, Fed. R. Evid. § 803(6).

On the other hand, the district court properly barred certain records of appellants' auditors, which were based on false information furnished by appellants and also contained a large measure of inadmissible hearsay. Insofar as the records may have tended to show the auditors' state of mind, their offer was directed towards an irrelevant issue. The legality of appellants' conduct was for the jury to determine on the basis of facts proven on the trial. There is no proof that appellants

relied upon the auditors' beliefs and, in the face of the overwhelming proof of knowing and intentional fraud, such reliance could not be inferred. *See United States v. King*, 560 F.2d 122, 132 (2d Cir.), *cert. denied*, 434 U.S. 925 (1977). This fact was correctly recognized by the district court when it refused to charge the jury on the issue of good faith reliance. *Id.* Conversations between an outside firm and its attorneys concerning the transaction of business with SGS was also properly excluded for similar reasons.

The district court's refusal to admit the testimony of more than two expert defense witnesses constituted proper management of the case.

John Lane's tape recordings of his conversations with appellant Orchard concerning some of the transactions at issue herein did not fall under the ban of 18 U.S.C. § 2511(2)(d) as having been made "for the purpose of committing any criminal or tortious act." Lane's purpose in making the recording was simply to protect the interests of his own firm should SFI and SGS attempt to breach their contract. *See Moore v. Telfon Communications Corp.*, 589 F.2d 959, 965-66 (9th Cir. 1978).

There is no substance in appellants' claims of prosecutorial misconduct. Information reported in the press was available in most instances from public proceedings and reported decisions. *See, e.g., In re SGS*, 530 F. Supp. 793 (S.D.N.Y.), *appeal dismissed* (2d Cir.), *cert. denied*, 456 U.S. 977 (1982); *In re Grand Jury Subpoenas Addressed to SFI*, 553 F. Supp. 71 (S.D.N.Y.), *aff'd mem.*, 714 F.2d 113 (2d Cir. 1982), *cert. denied*, 459 U.S. 1208 (1983). Appellants have not shown that any non-public information was released in such a manner as to have improperly influenced the jurors.

Appellants' *Brady* claim lacks merit. Appellants had full knowledge of the persons whose statements are at issue and the information available to those persons and thus were in a position themselves to call the witnesses and to take advantage of any exculpatory testimony they might furnish. *United States v. LeRoy*, 687 F.2d 610, 618-19 (2d Cir. 1982), *cert. denied*, 459 U.S. 1174 (1983).

The district court did not err in concluding that the Government's rebuttal summation was properly based on the record. To the extent, if any, that the prosecutor suggested any inferences not fully supported by the evidence, in view of the overwhelming proof of appellants' active and knowing participation in the fraudulent tax scheme, such transgression as may have occurred was harmless.

We reject appellant Antonucci's contention that he could not have been a participant in a conspiracy that involved fraud by both SFI and SGS, because he left SFI before SGS was formed. The district court properly instructed, *United States* v. *Tramunti*, 513 F.2d 1087, 1107 (2d Cir.), *cert. denied*, 423 U.S. 832 (1975), and left to the jury, *United States* v. *Bagaric*, 706 F.2d 42, 63 n.18 (2d Cir.), *cert. denied*, 104 S. Ct. 134 (1983), the question whether the evidence established a single conspiracy. The proof, which showed a substantial intermingling of SFI and SGS operations and employees, was sufficient to support the jury's determination that only a single conspiracy existed. The jury was instructed to disregard evidence concerning SGS in determining Antonucci's guilt, and can be presumed to have followed those instructions absent any showing to the contrary, *Shotwell Mfg. Co.* v. *United States*, 371 U.S. 341, 367 (1963).

Antonucci also fails in his contention that, because he resides outside the Southern District of New York and the customers whom he is charged with aiding and assisting filed their tax returns by mail, he was entitled to be tried in the district of his residence. *See* 18 U.S.C. § 3237(b). The district court correctly denied Antonucci's request for change of venue, relying on *In re United States (Clemente)*, 608 F.2d 76 (2d Cir. 1979), *cert. denied*, 446 U.S. 908 (1980), which held that section 3237(b) applies only where, unlike here, venue is predicated on the use of the mails.

The jury's verdict was properly rendered. Six days after beginning deliberations, the jury passed a note to the court stating that it could not reach a unanimous verdict. After informing counsel that he was prepared to take a partial

verdict and receiving no objection, Judge Owen asked the jury whether they had reached a verdict on any count. The foreman asked for more time to deliberate, because the jury was making progress. Later that day, the jury sent a note stating that it had reached unanimous decision on some counts but not others and that further deliberation would not prove effective. The jury was called into court, the verdict ws read, and the jurors were polled.

It is well established that a jury may be allowed to return a partial verdict as to some defendants or some counts. *United States v. Cotter*, 60 F.2d 689 (2d Cir.), *cert. denied*, 287 U.S. 666 (1932); Fed. R. Crim. P. 31(b). Nothing in the instant case indicates that the jury's partial verdict was intended to be anything but final, and the district court correctly treated it as such. Although the jury later inquired whether each of the counts should be judged collectively or individually, this does not indicate that the jury was reassessing appellants' guilt on the counts already decided. Likewise, the note from a juror indicating that she had felt pressured and had changed her convictions, furnishes no basis to challenge the unanimously rendered partial verdict. *United States v. Hockridge*, 573 F.2d 752, 756-60 (2d Cir.), *cert. denied*, 435 U.S. 821 (1978).

Appellant Michael Senft's contention that, in fixing his sentence, the district court impermissibly considered his protestations of innocence throughout the trial, is meritless. The court's statement upon sentencing, on which appellant relies, merely expressed regret at Senft's apparent lack of remorse, a valid sentencing criterion. *United States v. Grayson*, 438 U.S. 41 (1978).

We have fully considered all of appellants' contentions, including any not discussed in the above paragraphs, and find no merit in any of them. The judgments of conviction are affirmed. Mandate shall issue forthwith.

Hon. William H. Timbers

Hon. Ellsworth A. Van Graafeiland

Hon. Lawrence W. Pierce

N.B. Since this statement does not constitute a formal opinion of this court and is not uniformly available to all parties, it shall not be reported, cited or otherwise used in unrelated cases before this or any other court.

FROM

RULES OF THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
Supplementing the Federal Rules of Appellate Procedure

§ 0.23. Dispositions in Open Court or by Summary Order:

The demands of an expanding caseload require the court to be ever conscious of the need to utilize judicial time effectively. Accordingly, in those cases in which decision is unanimous and each judge of the panel believes that no jurisprudential purpose would be served by a written opinion, disposition will be made in open court or by summary order.

Where a decision is rendered from the bench, the court may deliver a brief oral statement, the record of which is available to counsel upon request and payment of transcription charges. Where disposition is by summary order, the court may append a brief written statement to that order. Since these statements do not constitute formal opinions of the court and are unreported and not uniformly available to all parties, they shall not be cited or otherwise used in unrelated cases before this or any other court.

Supreme Court, U.S.
FILED
OCT 10 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 85-43

In the Supreme Court of the United States

OCTOBER TERM, 1985

MICHAEL SENFT, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

CHARLES FRIED
Acting Solicitor General
GLENN L. ARCHER, JR.
Assistant Attorney General
ROBERT E. LINDSAY
GEORGE L. HASTINGS, JR.
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 633-2217

BEST AVAILABLE COPY

24pp

QUESTIONS PRESENTED

1. Whether petitioners were deprived of fair warning that their conduct was illegal.

2. Whether the district court (a) correctly declined to instruct the jury on petitioners' claim of reliance on advice of their accountants, in light of the absence of any support in the record for such a claim, and (b) correctly excluded testimony concerning advice that attorneys assertedly gave to a business associate of the petitioners, in light of the facts that the alleged advice did not address the legality of petitioners' conduct under the tax laws and that there was no evidence to indicate that petitioners had relied on any such advice.

3. Whether petitioners' right to a unanimous verdict was violated when the district court accepted the jury's verdicts on some but not all counts of the indictment.

TABLE OF CONTENTS

	Page
Opinion below	1
Jurisdiction	1
Statement	1
Argument	6
Conclusion	17

TABLE OF AUTHORITIES

Cases:

Boyce Motor Lines, Inc. v. *United States*, 342 U.S. 337	10
Commissioner v. *Court Holding Co.*, 324 U.S. 331	9
Frank Lyon Co. v. *United States*, 435 U.S. 561	9
Gorin v. *United States*, 312 U.S. 19	10
Gregory v. Helvering, 293 U.S. 465	9
Higgins v. *Smith*, 308 U.S. 473	9
Hygrade Provision Co. v. *Sherman*, 266 U.S. 497	10
Knetsch v. *United States*, 364 U.S. 361	9
Mattox v. *United States*, 146 U.S. 140	16
Rushen v. *Spain*, 464 U.S. 114	16
Screws v. *United States*, 325 U.S. 91	10
Smith v. *Commissioner*, 78 T.C. 350	6, 7, 8 9, 10
United States v. *Agard*, 605 F.2d 665	12
United States v. *Baskes*, 687 F.2d 165	9
United States v. *Bowman*, 720 F.2d 1103	12
United States v. *Burke*, 700 F.2d 70, cert. denied, 464 U.S. 816	17
United States v. *Clardy*, 612 F.2d 1139	9

Cases—Continued: Page

United States v. *Conforte*, 624 F.2d 869, cert. denied, 449 U.S. 1012 9
United States v. *Cotter*, 60 F.2d 689, cert. denied, 287 U.S. 666 16
United States v. *Coven*, 662 F.2d 162, cert. denied, 456 U.S. 916 9
United States v. *Dahlstrom*, 713 F.2d 1423, cert. denied, No. 83-1297 (May 14, 1984) ... 10
United States v. *DiLapi*, 651 F.2d 140, cert. denied, 455 U.S. 938 ..... 16, 17
United States v. *Fruehauf Corp.*, 577 F.2d 1038, cert. denied, 439 U.S. 953 9
United States v. *Hockridge*, 573 F.2d 752, cert. denied, 439 U.S. 821 16
United States v. *Little*, 753 F.2d 1420 10-11
United States v. *London*, 753 F.2d 202 9
United States v. *Patrick*, 542 F.2d 381, cert. denied, 430 U.S. 931 12
United States v. *Phillips*, 217 F.2d 435 11
United States v. *Powell*, No. 83-1307 (Dec. 10, 1984) 16
United States v. *Ragen*, 314 U.S. 512 10
United States v. *Raub*, 177 F.2d 312 9
United States v. *Saettele*, 585 F.2d 307, cert. denied, 440 U.S. 910 12
United States v. *Siegel*, 472 F. Supp. 440, aff'd *sub nom. United States* v. *Winograd*, 656 F.2d 279, cert. denied *sub nom. Siegel* v. *United States*, 455 U.S. 989 9
United States v. *Turkish*, 623 F.2d 769, cert. denied, 449 U.S. 1077 9
Wisniewski v. *United States*, 353 U.S. 901 ... 17

Constitution, statutes and rule:

	Page
U.S. Const.:	
Amend. V	6, 10, 11
Amend. VI	11
18 U.S.C. 371	1
26 U.S.C. 7201	2
26 U.S.C. 7206(2)	2
Fed. R. Evid. 606(b)	16

In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-43

MICHAEL SENFT, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The order of the court of appeals (Pet. App. 1a-7a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on March 29, 1985. A petition for rehearing was denied on May 10, 1985. The petition for a writ of certiorari was filed on July 8, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the Southern District of New York, petitioners were each convicted of conspiracy to defraud the United States by impeding and obstructing the lawful functions of the Internal Revenue Service through the creation of fraudulent tax deductions, in violation of 18 U.S.C. 371. Petitioner Michael Senft was also convicted

on 12 counts of aiding and assisting the filing of false income tax returns, in violation of 26 U.S.C. 7206(2), and one count of attempted evasion of federal income tax, in violation of 26 U.S.C. 7201. Petitioners Antonucci and David Senft were each also convicted on 12 counts of aiding and assisting the filing of false tax returns, and petitioner Orchard was convicted on one such count (C.A. App. 391). Petitioner Michael Senft was sentenced to a total of 15 years' imprisonment and fined $80,000. Petitioner Orchard was sentenced to four years' imprisonment and a $15,000 fine; petitioner David Senft to two years' imprisonment, three years' probation, and a $70,000 fine; and petitioner Antonucci to six months' imprisonment, three years' unsupervised probation, and a $10,000 fine (C.A. App. 486). The court of appeals affirmed (Pet. App. 1a-7a).

The evidence at trial "convincingly established [petitioners'] guilt on all the counts on which they were convicted" (Pet. App. 2a) and involved "overwhelming proof of knowing and intentional fraud" (*id.* at 4a). In brief, petitioners engaged in a scheme to supply customers with documentation for fraudulent tax deductions based on losses purportedly suffered in alleged trading in government securities.

Under the overall direction of Michael Senft, petitioners' activities took place essentially in two stages. In 1979 and 1980, petitioners operated Sentinel Financial Instruments (SFI), a New York limited partnership. Petitioners sold investors a program allegedly involving trading in Department of Treasury bills and notes. According to its literature on this program, SFI would obtain for its customers pairs of positions in Treasury bills and notes "hedged" to minimize the financial risk to the investor. Under the arrangement, a customer would purportedly purchase notes payable on a certain future date, and at the same time sell bills "short"—*i.e.*, bills

that the customer did not yet own—payable at about the same time. The hedged trades were to be designed so that near the end of the first tax year the customer would recognize a loss on the unprofitable leg of the hedged pair of positions (typically, by purchasing Treasury bills to "cover" the short sales), which he could deduct from ordinary income; then, in the second year, he would recognize corresponding gain on the other leg of the hedged pair (typically, by selling Treasury notes), which would be taxable at the lower rates for capital gains. SFI represented that it would attempt to make an economic profit for the investor by investing at times when the anticipated increase in the value of Treasury notes would be greater than the increases in the value of bills. SFI purportedly would make its profits chiefly by charging a mark-up or mark-down on bills it sold or bought on behalf of customers. Tr. 169, 177, 182; GX 102, at 2-4, 8-14.

In reality, however, the SFI program operated in an entirely different fashion. In effect, the customer merely indicated the amount of tax loss he desired and furnished as a "deposit" an amount computed as a percentage of that desired loss. SFI then created a paper trail of documents for nonexistent "trades" of bills and notes that made it appear that the customer had suffered the desired loss by actual trading in that year. See, *e.g.*, C.A. App. 429-430; Tr. 169-172, 627-630; GX 106.[1]

Specifically, petitioners made accounting entries showing that bills or notes had been bought from or sold to SFI by customers at indicated prices on given dates. SFI was on the other side of all its customers' purported "trades." Sufficient "trades" were created for a cus-

---

[1] Since they were not needed for actual trading, funds purportedly collected from customers as "margin deposits" for such trading were, in fact, invested in corporate bonds for SFI's account (Tr. 513).

tomer's account to establish the desired loss for the customer in the first year and a corresponding capital gain in the later year. In fact, however, no actual trading of securities occurred, and the accounting entries never evidenced any actual transactions or indebtedness between parties. The purported trades were recorded not at current market prices, but typically at prices based on the previous day's trading as reported in the *Wall Street Journal.* The "trading" results were created so that no customer would take an economic profit or loss no matter what happened in the actual government securities market.[2] See C.A. App. 280; Tr. 169-172, 174-179, 346, 353-354, 611-616, 629, 703-705, 1133.

Moreover, the "trading" accounting entries were routinely disregarded or altered after the fact. Most often this was done by retroactive creation of alleged trades (Tr. 198-218, 355-363, 469-470, 518-520, 566-567, 618-619, 625-626, 856-857, 979-981, 1479-1480; GX 324). For example, when in early 1980 petitioners discovered that the desired losses for 1979 had not been achieved for many customers, they simply changed their accounting entries to indicate that trades had been made during 1979 (Tr. 198-218, 567, 618-619, 626). Thus, the reality was that from the day an account was opened, the customer's tax loss for the first year, the amount of his deposit that was to be kept by SFI as its fee, and the amount thereof to be returned to the customer at the end of his program were already known (C.A. App. 429-430; Tr. 169-172, 353-354, 615-616, 627-630, 703-705; GXs 106, 303).

---

[2] The sole exception to this rule was that a few individuals were selected by petitioners to make economic profits, and a few actual trades were performed, expressly to conceal the scheme from potential IRS audits (see Tr. 218, 225, 242-243, 521-524, 563, 626-627, 708-709, 713, 1460-1461).

In 1980, petitioners created a new limited partnership, Sentinel Government Securities (SGS), to conduct in a slightly different way their scheme of creating false tax deductions. In this program, customers would become limited partners in SGS. Thus, instead of executing purported trades for a customer's own account with SFI on the other end of each trade, trades would purportedly be carried out between SGS itself and another securities dealer. The purported tax deductions would then be "passed through," pursuant to partnership tax provisions, to the limited partners of SGS in their allocable shares (Tr. 631-632).

As with SFI, however, the actual operation of SGS consisted of accepting fees from customers in return for the creation on paper of alleged trades that in fact had no economic significance. SGS negotiated arrangements with other government securities dealers under which, for a fee paid by SGS to the other dealer, documents attesting to purported trades between the dealers would be created showing that SGS had achieved the desired losses in one year and corresponding gains in later years. The transactions were prearranged so that, beyond the fee, both sides would be guaranteed of having no economic gain or loss (Tr. 634-637, 710, 753-761, 858-861, 913-916, 956-957, 1269-1271, 1278-1281, 1388-1394). To disguise the nature of the transaction, the fee was to be paid through a series of additional prearranged transactions in which SGS would intentionally lose money to the other dealer (Tr. 635-637, 759-760, 916-917). Once again, backdating of transactions was routinely employed when necessary to ensure that tax losses were created by the end of a tax year (Tr. 1010-1011, 1479-1483, 1582(12)-1582(17)).

Under the SFI and SGS schemes, petitioners generated for their customers a total of approximately $130 million in fraudulent tax deductions for the tax

years 1979 and 1980 (Tr. 1506-1510). Michael Senft, as a partner in SGS, personally used his fraudulent deduction to reduce his 1980 taxable income from $1,866,076 to zero (Tr. 1511, 1515-1516).

ARGUMENT

1. Petitioners argue (Pet. 9-15) that they could not reasonably have anticipated that the activities that led to their convictions were illegal, and thus that their right to "fair warning" under the Due Process Clause of the Fifth Amendment was violated. Citing the Tax Court's decision in *Smith* v. *Commissioner,* 78 T.C. 350 (1982), they contend that their "tax shelter" program was similar to the "tax straddle" plan involved in *Smith* that the Tax Court found was not a total sham, and hence that they were criminally convicted in this case for offering their customers what they could have believed to have been at least an arguably valid tax shelter program.[3]

Contrary to their argument, the scheme actually operated by petitioners was a far cry from the program at issue in *Smith.* In the program involved in the *Smith* case, taxpayers made so-called "butterfly straddle" investments in commodity futures, which involved "hedged" pairs of contracts to buy and to sell the same commodity on different future delivery dates. All trades were in fact duly registered and carried out in the official sessions of the regulated Commodities Exchange, Inc. (COMEX). In the portion of the *Smith* opinion cited by petitioners (78 T.C. at 372-385), the Tax Court concluded that these individual transactions were not total shams devoid of substance, since the investors actually

[3] Petitioners do not contend that they actually relied on *Smith,* which was decided after they had engaged in the conduct charged in this case.

entered into real, legally binding obligations to buy and sell commodities pursuant to valid COMEX rules in authorized COMEX trading sessions (see especially 78 T.C. at 385).[4]

In this case, while the program advertised by petitioners may have had some similarities to that in *Smith*, the scheme actually operated did not. No actual trades were ever conducted or registered on any exchange. Moreover, it is clear that the accounting entries in the SFI and SGS books, supposedly signifying effective and binding trades between distinct parties, had in reality no substance whatsoever. The final results of each customer's trading were exactly preordained, and customers were specifically precluded from ever obtaining any profit. And the accounting entries were routinely created long after the alleged fact, backdated, and changed; for example, if accounting records showed that previously recorded "trades" left one party "owing" another an amount not anticipated, the entries were changed or another "trade" was created on paper to

---

[4] In *Smith*, the Tax Court ultimately denied the investors any deductions for losses suffered on the straddle investments when the "loss leg" of the straddle was disposed of in the initial tax year. First, the court concluded that the investment contracts were in fact largely devoid of the economic substance claimed by the investors, since the prices used in the trades had been specifically picked to yield large paper losses and did not conform to the most accurate market prices for the commodities on the date of the contracts; for example, the court found that in one case the claimed economic loss of $95,424 on a trade in fact amounted to a true loss of only $5,754. See 78 T.C. at 378-384. Second, even as to these small actual losses, the court concluded that the investors were not entitled to a deduction because they were essentially assured of coming out nearly even on the total straddle transaction when the gain on the other leg of the straddle was realized in the later year, and thus the losses did not meet the requirement for deductibility that they be incurred in a transaction entered into for profit. See 78 T.C. at 390-394.

balance the account. Thus, while in *Smith* there was actual trading, albeit carefully done to minimize risk, in this case the bogus accounting entries, frequently disregarded or retroactively changed, did not represent any real transactions of actual economic substance.

In addition, the program in *Smith* was an open and above-board attempt to take advantage of a perceived opportunity for deductions under the tax law. By contrast, the scheme here was a disguised operation the true nature of which petitioners attempted to conceal from the Internal Revenue Service and even from its own customers. Beginning with their initial promotion of the scheme, petitioners falsely represented both that the program would attempt to seek an economic profit for its customers and that petitioners' profit would be earned on mark-ups in securities bought from or sold to customers rather than as a percentage of a loss amount "sold" to a customer (GX 102, at 2-4, 8-14). Later inquiries from both customers and the IRS elicited identically false representations from petitioners (GXs 132, 601A, 602B, 604B, 606B, 612). "Trading tickets," designed to convince customers that trades had actually been made, were routinely created by turning back the date on the ticket-stamping machine (Tr. 198-218, 355-363, 469-470, 518-520, 566-567, 574-575, 616-619, 625-626, 856-862, 966-969, 979-981, 1121, 1479-1480). When transactions were backdated, evidence of that fact was ordered destroyed (Tr. 203-206, 981-982, 1112-1113). And indeed, when it became known that the Internal Revenue Service planned to audit SFI, petitioner David Senft ordered the removal of numerous documents that he apparently believed to be incriminating (Tr. 997-999, 1582(10)-1582(11); GX 519).

These attempts by petitioners to conceal the true nature of their operation clearly indicate that they knew that their scheme bore little resemblance to arguably bona fide "tax shelter" programs, such as that in-

volved in *Smith*, but instead amounted to pure fraud. It has long been held, and obviously was well-known to petitioners, that purported transactions without any economic effect will be disregarded for tax purposes and cannot properly be the basis for deductions. See, *e.g.*, *Frank Lyon Co.* v. *United States*, 435 U.S. 561, 573 (1978); *Knetsch* v. *United States*, 364 U.S. 361 (1960); *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945); *Higgins* v. *Smith*, 308 U.S. 473, 477 (1940); *Gregory* v. *Helvering*, 293 U.S. 465, 469-470 (1935). Accordingly, courts have regularly sustained criminal tax convictions based on sham transactions involving fraudulent intent. See, *e.g.*, *United States* v. *Baskes*, 687 F.2d 165 (7th Cir. 1981); *United States* v. *Conforte*, 624 F.2d 869, 873-875 (9th Cir.), cert. denied, 449 U.S. 1012 (1980); *United States* v. *Turkish*, 623 F.2d 769, 771 (2d Cir. 1980), cert. denied, 449 U.S. 1077 (1981); *United States* v. *Clardy*, 612 F.2d 1139, 1151-1153 (9th Cir. 1980); *United States* v. *Fruehauf Corp.*, 577 F.2d 1038, 1068 (6th Cir.), cert. denied, 439 U.S. 953 (1978); *United States* v. *Raub*, 177 F.2d 312, 313-314 (7th Cir. 1949). Indeed, in at least two cases, convictions under the same statutes at issue here have been upheld for activities that, like those of petitioners, nominally utilized "tax straddles" but lacked substance overall. See *United States* v. *Turkish*, 623 F.2d at 771; *United States* v. *Siegel*, 472 F. Supp. 440, 441-443 (N.D. Ill. 1979), aff'd *sub nom. United States* v. *Winograd*, 656 F.2d 279 (7th Cir. 1981), cert. denied *sub nom. Siegel* v. *United States*, 455 U.S. 989 (1982); see also *United States* v. *London*, 753 F.2d 202 (2d Cir. 1985); *United States* v. *Coven*, 662 F.2d 162 (2d Cir. 1981), cert. denied, 456 U.S. 916 (1982).[5]

---

[5] Petitioners suggest in passing (Pet. 13-14) that the district court's instruction to the jury was inconsistent with *Smith*. For the reasons previously discussed, however, *Smith* is distinguishable from this case and does not affect the correctness of the instruc-

Additionally, this case presents no "fair warning" problem under the Due Process Clause because the crimes of which petitioners were convicted require specific intent to commit prohibited acts. Such a scienter requirement "reliev[es] the statute of the objection that it punishes without warning an offense of which the accused was unaware." *Screws* v. *United States*, 325 U.S. 91, 102 (1945); see also *Boyce Motor Lines, Inc.* v. *United States*, 342 U.S. 337, 343 (1952); *United States* v. *Ragen*, 314 U.S. 512, 524 (1942); *Gorin* v. *United States*, 312 U.S. 19, 26-28 (1941); *Hygrade Provision Co.* v. *Sherman*, 266 U.S. 497, 502-503 (1925). As this Court stated in *Ragen*, 314 U.S. at 524, "[a] mind intent upon willful evasion is inconsistent with suprised innocence." Thus, since the jury in this case, in order to convict, was specifically required to find (see C.A. App. 41-42) that petitioners engaged in acts that they knew to be prohibited, and since that finding is not challenged and is amply supported by the record, petitioners' claim of lack of notice of the illegality of their conduct is plainly without merit.[6]

---

tion here. Moreover, the Tax Court in *Smith* in fact *denied* the investors' deductions because the losses were not incurred in transactions entered into for profit (see page 7 note 4, *supra*). Similarly here, there would be no transaction for profit if, as the district court instructed the jury, the purported transactions "in their totality * * * were not intended to have and in fact had no economic substance or significance" (C.A. App. 41); consequently, petitioners' scheme was illegal because it was designed to create tax deductions for ostensible losses that, under well-established principles, were not deductible.

[6] In light of the clearly illegal nature of their scheme, petitioners err in relying (Pet. 14-15) on *United States* v. *Dahlstrom*, 713 F.2d 1423, 1428 (9th Cir. 1983), cert. denied, No. 83-1297 (May 14, 1984). *Dahlstrom* concerned advocacy of the use of a tax shelter whose legality "was completely unsettled." In that circumstance, the court held only that "the first amendment barred prosecution for advocacy of conduct which did not violate existing law." *United*

2. Petitioners argue (Pet. 16-24) that the district court erred in (a) refusing to give a proposed jury instruction concerning their alleged reliance on accountants and (b) excluding proffered testimony concerning alleged consultations between a business associate of petitioners' and his attorneys. The court of appeals correctly held that these trial rulings were not erroneous (Pet. App. 3a-4a).

a. Initially, petitioners contend (Pet. 17-21) that the district court's action punished them for not relinquishing their Fifth Amendment right not to testify at trial. This contention rests on the mistaken premise that the court refused the instruction because petitioners declined to take the witness stand themselves and offer personal testimony that they had relied on the accountants. Contrary to petitioners' assumption, the district court's ruling was properly based on the conclusion that there was no evidence in the record—whether in the form of testimony from petitioners or otherwise—to indicate any such reliance by petitioners (Tr. 1951-1957). Thus, this ruling did not implicate petitioners' Fifth Amendment rights.[7]

Similarly, the district court's rejection of the proposed instruction did not violate petitioners' Sixth Amendment right to present a defense. The refusal to instruct the jury as petitioners requested—that it should acquit

---

States v. *Little*, 753 F.2d 1420, 1434 (9th Cir. 1984). That reasoning plainly has no application here.

[7] Accordingly, no conflict exists with *United States* v. *Phillips*, 217 F.2d 435, 440-443 (7th Cir. 1954), in which the court ruled that a defendant was entitled to a "reliance on advice" instruction even though the evidence of reliance was introduced by the prosecution rather than the defense. That decision is entirely consistent with the district court's refusal to give such an instruction in this case because of the absence of any supporting evidence whatever.

if it found that petitioners relied in good faith on the advice of fully informed accountants that their operation was legal (see Pet. 17-18 n.8)—was properly based on the fundamental rule that a trial court should not give a defense instruction that is not supported by any evidence. See, *e.g.*, *United States* v. *Bowman*, 720 F.2d 1103, 1105 (9th Cir. 1983); *United States* v. *Agard*, 605 F.2d 665, 667 (2d Cir. 1979); *United States* v. *Saettele*, 585 F.2d 307, 309 (8th Cir. 1978), cert. denied, 440 U.S. 910 (1979); *United States* v. *Patrick*, 542 F.2d 381, 386 (7th Cir. 1976), cert. denied, 430 U.S. 931 (1977). In this case, there was no evidence that the accountants gave petitioners any advice, much less informed advice, that the tax benefits claimed for their program were legally available (Pet. App. 3a-4a). While petitioners assert (Pet. 17-18) that the accounting firm for SFI and SGS gave those operations "clean" bills of health, the very member of that accounting firm on whose testimony petitioners rely made it clear at trial that those opinions had nothing whatever to do with the propriety of the claimed tax benefits for the transactions, but rather were merely opinions that those entities' financial statements fairly represented their financial positions in accordance with accepted accounting principles (Tr. 1737-1740).

Furthermore, any "advice" from the accountants could not be considered to have been "informed," since they were never advised of the routine backdating of transactions, the payment of fees for trading confirmations through rigged transactions in which SGS purportedly "lost" money to other dealers, and the numerous additional improprieties involved here (Tr. 661-662, 707-709, 1720-1721, 1729-1733). Nor have petitioners shown that the district court's ruling prejudiced them in any event, since the court properly instructed the jury on the issues of willfulness and specific intent

(C.A. App. 69-71, 77-78), and defense counsel repeatedly argued in summation that petitioners' contacts with their accounting firm showed that they did not possess such intent (Tr. 2049, 2153, 2155, 2159, 2226-2230, 2232-2236, 2247-2252, 2272-2273, 2283-2284).

b. Likewise, contrary to petitioners' argument (Pet. 21-24), the district court properly declined to allow testimony by Joseph Vitrella, an employee of one of the dealers that engaged in purported trading with SGS. Vitrella assertedly would have testified that he mentioned to petitioner Orchard that attorneys for Vitrella's firm had found nothing illegal on that firm's part in engaging in trading with SGS. The district court properly found that the proffered testimony was irrelevant (see C.A. App. 149-155). The alleged opinion of the attorneys for Vitrella's firm that that firm had not acted illegally in "trading" with SGS did not in any way bear on the issue whether the tax benefits held out to customers by SFI and SGS had or could have been believed to have had a legitimate basis in law. And, as above, there was no showing either that the attorneys were adequately informed (or informed at all) about petitioners' operations or that petitioners relied on the opinion of the attorneys.

Indeed, the overall pattern of evidence negated any inference that petitioners could have relied on the purported opinion of Vitrella's attorneys. At the time of Vitrella's alleged conversation with Orchard, petitioners' general scheme had long been in operation in the form of SFI, and the additional vehicle involving the purported trading between SGS and other dealers was already developed and had been proposed by petitioners to Vitrella's firm and to at least one other dealer (Tr. 634-637, 710, 753-761, 858-861, 913-916, 956-957, 1388-1394). Thus, no reasonable argument could have been made that petitioners devised and operated their

program in reliance upon the purported opinion of Vitrella's attorneys that arose so late in the sequence of events. Accordingly, the district court did not err in excluding the proffered testimony as not being probative of any relevant matter.

3. Petitioners and co-defendant Frank Susi were tried on a total of 63 counts of conspiracy to commit fraud, attempted tax evasion, and aiding and assisting the filing of false tax returns. The jury could reach a verdict only as to certain counts, on which petitioners were convicted; as to the remaining counts, including those involving Susi, a mistrial was declared on the ground of a hung jury. See C.A. App. 390-392, 477. Petitioners claim (Pet. 24-26) that the verdicts rendered by the jury on some but not all counts of the indictment were not intended by all jurors to be final, thus depriving petitioners of their right to a unanimous verdict.

This fact-bound claim is plainly belied by the record. During its consideration of the case, the jury sent the district court a note that it could "not come to a unanimous decision" (C.A. App. 476). After further deliberations, the jury sent a second note stating (C.A. App. 477):

> We have reached a unanimous decision on some of the counts, but cannot reach a unanimous decision on others. We do not feel that additional deliberation will help at all.

The district court, without objection from defense counsel, then brought in the jury (C.A. App. 390-392) and took its verdicts on those counts on which, in the jury's words, it had "reached a unanimous decision." The individual jurors were polled, and each affirmed the verdicts convicting petitioners (C.A. App. 392).

These proceedings demonstrate that the jury considered its verdicts to be unanimous and final. The jury's

note expressly stated that unanimous decisions had been reached on some counts, and the contemporaneous understanding of the parties at the trial likewise was that those verdicts represented a binding determination of guilt. Indeed, the jury specifically requested that it be relieved from further deliberations at that point, a request that is flatly inconsistent with petitioners' claim on appeal that the jury contemplated additional proceedings and did not consider its verdicts of guilty to be final. As the district court found (Tr. 2670):

> [T]he note makes it perfectly clear that they regarded their duties as at an end [when they returned the note]. They not only had decided the things they were going to decide but on the things they hadn't decided they felt further deliberations would not help at all. This was not attentive [*sic*, a tentative] vote. This was a rendering of a verdict on those counts that they were unanimous on but they were not able to reach a unanimous decision on others and felt that further deliberations would not help at all. So, I don't see this as attentive [*sic*, a tentative] vote. They had no expectation of having further deliberations.

After taking the jury's partial verdict, the district court asked the jurors to continue deliberating on the other counts (C.A. App. 392). These deliberations ultimately proved fruitless, but at one point the jury issued a further note to the court, inquiring (C.A. App. 479) "[s]hould each count from 2 to 27 be judged collectively or individually determined?" Pointing to the fact that certain of the counts on which the guilty verdicts had previously been returned were included in Counts 2 through 27, petitioners assert (Pet. 25 (emphasis in original)) that this note "clearly indicate[s] that [the jury] had not in fact understood that, by reporting its partial verdicts, it was reporting *final* verdicts."

Contrary to petitioners' assertion, this note does not detract from the above conclusion that the partial verdicts were unanimous and final. Rather, the note is ambiguous and is most plausibly read, in the overall context, to mean that the jury was unclear either (1) whether its verdicts of guilty on the related counts required it to convict petitioners on the remaining counts as well, or (2) whether it should find all of the defendants, "collectively," guilty on the remaining counts, as it had in the counts on which verdicts had already been returned, or whether it was to consider them "individually." However the note is construed, it cannot reasonably be taken to contradict the jury's previous understanding, clearly indicated by the record, that its partial verdicts were a unanimous and final disposition against petitioners on those counts.[8]

Thus, as the court of appeals concluded (Pet. App. 6a), "nothing in the instant case indicates that the jury's partial verdict was intended to be anything but final, and the district court correctly treated it as such."[9]

---

[8] Petitioners also suggest (Pet. 25 n.13) that a note from an individual juror to the district judge well after the partial verdicts were taken, which stated that the juror felt that she had been "pressured" into the verdicts because she was "outnumbered" (C.A. App. 478), indicates that the partial verdicts were not unanimous and final. It is well established, however, that a verdict cannot be impeached by testimony or evidence of a juror's mental processes in agreeing to the verdict. See, *e.g.*, Fed. R. Evid. 606(b); *United States* v. *Powell*, No. 83-1307 (Dec. 10, 1984), slip op. 9; *Rushen* v. *Spain*, 464 U.S. 114, 121 n.5 (1983); *Mattox* v. *United States*, 146 U.S. 140, 148-149 (1892). This rule is fully applicable to the partial verdicts at issue here. See, *e.g.*, *United States* v. *Hockridge*, 573 F.2d 752, 756-760 (2d Cir.), cert. denied, 439 U.S. 821 (1978); *United States* v. *Cotter*, 60 F.2d 689, 690-691 (2d Cir.), cert. denied, 287 U.S. 666 (1932).

[9] Petitioners' reliance (Pet. 25) on *United States* v. *DiLapi*, 651 F.2d 140, 146-147 (2d Cir. 1981), cert. denied, 455 U.S. 938 (1982), is misplaced. First, an asserted intracircuit conflict provides no

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

CHARLES FRIED
Acting Solicitor General
GLENN L. ARCHER, JR.
Assistant Attorney General
ROBERT E. LINDSAY
GEORGE L. HASTINGS, JR.
Attorneys

OCTOBER 1985

---

basis for this Court's review. See *Wisniewski* v. *United States*, 353 U.S. 901 (1957). In any event, contrary to petitioners' interpretation, *DiLapi* does not establish a rigid rule that a district court must formally advise a jury that its verdict is final before accepting a partial verdict. Rather, *DiLapi* involved the district court's decision not to take a partial verdict, which was affirmed in the circumstances of that case. The court of appeals' statement in *DiLapi* that partial verdicts should not be based on "tentative votes" (651 F.2d at 147) has no application where, as here, the jury clearly intended to return a final verdict. See also *United States* v. *Burke*, 700 F.2d 70, 80 (2d Cir.), cert. denied, 464 U.S. 816 (1983).